

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 98-653-S - ORDER NO. 2000-675
AUGUST 21, 2000

IN RE: Application of Palmetto Utilities, Inc. for) ORDER DENYING
Approval of an Increase in its Rates and) PETITIONS FOR
Charges for its Sewer Services.) REHEARING OR
) RECONSIDERATION
) AND APPROVING
) BOND

This matter comes before the Public Service Commission of South Carolina (the Commission) on two Petitions for Rehearing or Reconsideration of Order No. 2000-0481, filed by the Consumer Advocate for the State of South Carolina (the Consumer Advocate), and Palmetto Utilities, Inc. (Palmetto or the Company), respectively. For the reasons stated below, both Petitions must be denied on their merits. Palmetto also included in its Petition a request for approval of a bond. Also for the reasons stated below, we approve the form and amount of the bond proposed by the Company.

First, the Consumer Advocate's Petition alleges that the Commission's decision to decline to count plant impact fees as revenue fails to make findings of fact supported by evidence of record in violation of S.C. Code Ann. Section 1-23-350 (1976). Further, the Consumer Advocate states that our decision is arbitrary, capricious, an abuse of discretion, and not supported by the evidence of record in violation of S.C. Code Ann. Sections 1-23-380(A)(6)(e) and (f) (Supp. 1999). The basis for the Consumer Advocate's allegation is that, in its testimony, the Company has stipulated that the plant impact fees collected are used as any other revenue for

day to day operations, including interest expense and debt service. According to the Consumer Advocate, the Company treats the plant impact fees as revenues, but does not account for them at all, and obtains substantial sums in this manner. Also, the Consumer Advocate states that without a proper adjustment, the Company is given test year expenses, but not the post test year increase in revenues generated by the plant impact fee charged to the 675 single family equivalents that were added to the system in the test year. The Consumer Advocate concludes that the recognition of expenses without the corresponding increase in revenues will violate the principle that operating revenues should match operating expenses.

We decline to reconsider. First, we disagree that we have failed to make proper findings of fact, nor are our findings arbitrary, capricious, or otherwise in violation of the Administrative Procedures Act. Order No. 2000-0481, starting at 20, provides an analysis of our holding. First, we express reservations about notice to the Company as to a policy on plant impact fees. We therefore declined to order that the monies be escrowed or placed in a separate account. Further, although we did not count plant impact fees as revenues in this particular case, we did note that the evidence raised a real question in our minds as to the proper accounting treatment of plant impact fees in general in water and wastewater cases. Accordingly, we established a generic Docket to more fully investigate this subject. The question presented was somewhat of a novel one for our jurisdiction, so we felt it necessary to further develop an appropriate policy through investigation, including requiring that Staff check with other jurisdictions to determine their accounting treatment of such fees. Thus, the matter is far from concluded. We intend to develop a policy for the proper accounting treatment of plant impact fees in the near future, so that we can properly rely on it in future cases. Such a holding is hardly arbitrary, capricious, or otherwise in violation of the Administrative Procedures Act.

At least for the present, until we more fully develop this policy, we believe that the treatment of plant impact fees as contributions in aid of construction by the Company is appropriate. See Tr. p. 289, lines 8-9; p. 291, lines 17-20. This accounting treatment lowers the utility's overall cost of operation and reduces its operating margin. See Hamm v. South Carolina Public Service Commission (Wild Dunes), 309 S.C. 295, 422 S.E. 2d 118 (1992). We believe, at least for now, that Palmetto does accord "meaningful accounting treatment" to the plant impact fees it collects.

Second, the record shows that Palmetto collects plant impact fees to recover a portion of the capacity created by investment in plant and facilities already made. See, e.g., Tr. p. 248, lines 4-12; p. 266, line 17- p. 267, line 15; *see also* 26 S.C. Code Ann. Regs. 103-502.11 (Supp. 1999) ("tap fee" defined to include "a portion of plant capacity which will be used to provide service to the new customer")

Third, the effect of not including plant impact fees in test year revenues at this time will not result in the recognition of expenses without the corresponding increase in revenues as the Consumer Advocate contends. Treating plant impact fees as contributions in aid of construction reduces Palmetto's utility plant in service and thereby any test year operating expenses, such as taxes and depreciation, which are associated with the provision of existing capacity. See Tr. p. 235, line 21-p. 238, line 10; p. 240, line 7-p. 241, line 18. See also, Wild Dunes, supra. It should also be noted that Order No. 2000-0481 adopted the Commission Staff's adjustments to revenues based on a billing analysis that recognizes the additional annual revenues generated by new customers during the test year. See Order No. 2000-0481 at 18. Thus, the "mismatch" feared by the Consumer Advocate does not occur. Again, however, we intend to fully analyze the entire

accounting scenario with plant impact fees at a later date. In any event, the Petition of the Consumer Advocate must be denied and dismissed.

Palmetto Utilities also filed a Petition for Rehearing or Reconsideration, based on several grounds.

First, Palmetto objects to this Commission adopting the Commission Staff's proposed adjustment to operating expenses, including an interest synchronization adjustment using a hypothetical 50-50 capital structure. As Palmetto notes, the effect of this one adjustment was to disallow approximately \$310,000 of \$390,000 in book interest expense. Our Order No. 2000-0481 found interest synchronization to be proper, since it allowed interest expense for ratemaking purposes associated only with that investment upon which the utility is allowed to earn a rate of return and/or operating margin. (emphasis added) Palmetto alleges that the Order disregarded or overlooked the fact that Palmetto's rates in this case were set using operating margin methodology and were not based upon an allowable return on its investment. The Company further states that the operating margin approach does not utilize a return on the utility's investment, or rate base, but instead compares the utility's net operating income for return with its total operating revenues. Palmetto concludes that because Palmetto's rates were not set by using a return on its investment, Order No. 2000-0481 improperly adopted an interest synchronization adjustment to allow interest that is hypothetically associated with the utility's investment.

Palmetto overlooks our discussion correlating interest synchronization with the investment upon which the utility is allowed to earn an operating margin. See Order No. 2000-0481 at 16. Therefore, the fact that the operating margin was employed in the present case was

discussed in that portion of the Order addressing the interest expense. This ground is without merit.

Palmetto also takes issue with the fact that the interest synchronization adjustment was adopted in Order No. 2000-0481 instead of an alternative treatment of interest allowed in the Company's last rate Order, Order No. 97-699. Palmetto's point is that Order No. 97-699 established a precedent, and an administrative agency "cannot act arbitrarily in failing to follow established precedent," as set out in 330 Concord Street Neighborhood Ass'n v. Campsen, 309 S.C. 514, 424 S.E. 2d 538 (Ct. App. 1992). First, we stated in Order No. 97-699 that our treatment of interest expense in that Order was not necessarily precedential. Thus, we felt free in Order No. 2000-0481 to use the interest synchronization methodology. We believe that we properly set out our reasoning in the latter Order for treating interest the way that we did. This is actually consistent with Campsen, a South Carolina Court of Appeals case which holds that an agency's action must be supported by substantial evidence. We utilized interest synchronization because we believed that "it allowed interest associated only with that investment upon which the utility is allowed to earn a rate of return and/or operating margin." Order No. 2000-0481 at 16.

Further, the setting out of a specific reason for deviating from prior policy is consistent with the South Carolina Supreme Court's ruling which actually debunks somewhat the idea of Commission "precedent" as a basis for any Commission holding. Hamm v. South Carolina Public Service Commission and South Carolina Electric and Gas Company, 309 S.C.282, 422 S.E. 2d 110 (1992) holds that a previously adopted policy may not furnish the sole basis for a Commission action. It appears that Palmetto would have us use a previously adopted position as the sole basis for our action in this case.

Further, even if we accept Palmetto's allegation about a lack of non-utility property, we still believe that the adjustment to interest expense adopted by us in Order No. 2000-0481 was proper, since the rate base in this case had also been substantially reduced by contributions in aid of construction, and because the interest synchronization allowed interest expense for ratemaking purposes associated only with that investment upon which the utility is allowed to earn an operating margin. The interest expense adjustment adopted by us in our prior Order makes logical sense, and we do not believe that we were bound to follow our Order No. 97-699 as precedent on this expense, as long as we stated a proper reason for it.

The next ground stated in Palmetto's Petition for Rehearing or Reconsideration involves Palmetto's rate case expenses. At the hearing on the matter, Palmetto presented testimony that an additional \$21,551 in rate case expenses had been incurred since the Staff conducted its audit. Palmetto had asked that this amount be included in total rate case expenses. Palmetto states that this issue was not addressed in Order No. 2000-0481. We hold that these additional rate case expenses are not allowable, since the Commission Staff was not given the opportunity to audit the numbers prior to their submission into evidence. Therefore, we do not know whether these additional expenses were reasonable or not. This ground is therefore without merit.

As its final ground for rehearing or reconsideration, Palmetto takes issue with the Commission's holding that Palmetto should have the opportunity to earn a 8.40% operating margin. The allegation is that there was no finding that this constituted a fair and reasonable operating margin, nor was there evidence to support such a finding. Palmetto alleges that the only evidence of record is to the effect that, even if all of the Commission Staff's proposed accounting adjustments were adopted, a reasonable operating margin for Palmetto in this case is

10.88%. Therefore, Palmetto proposes the theory that our Order should have adopted an operating margin of 10.88% instead of 8.40%. Such is not the case.

The operating margin is determined by dividing the net operating income or loss for return by the total operating revenues of the utility. Order No. 2000-0481 at 19. That Order then determined the Company's present operating margin, based on the Company's gross revenues for the test year, after accounting and pro forma adjustments under the presently approved rate schedules, the Company's operating expenses for the test year after accounting and pro forma adjustments, and customer growth. Order No. 2000-0481 at 19-20. The Commission then examined the factors delineated in the Bluefield and Seabrook Island Property Owners Association cases. These factors consisted of a balancing of the revenue requirements of the Company and the proposed price for the sewer service, the quality of the service, and the effect of the proposed rates upon the consumer. Based on these considerations, the Commission concluded that the Company should have the opportunity to earn a 8.40% operating margin. The Commission then shows how the 8.40% operating margin is calculated in Table B. Order No. 2000-0481 at 21. Operating expenses are subtracted from operating revenues to arrive at a net operating income. Customer growth is figured into the mix to get a total income for return. Operating margin may be figured by dividing the net operating income figure by the operating revenues figure, after removing interest. In this case, 8.40% is the operating margin that results from this calculation. Thus, we showed in Order No. 2000-0481 how this operating margin was calculated.

We would note that an operating margin is not an appropriate subject for expert testimony, such as rate of return, but is more properly gleaned from an overall look at the circumstances and figures presented by the Company and its adversaries in a rate case.

There is no statutory authority prescribing the method which this Commission must utilize to determine the lawfulness of the rates of a public utility. Also, since the operating margin is a simple calculation, and not a matter for the presentation of expert testimony, we hold that we, as the statutory designee of the General Assembly on utility rate case matters, have the right to grant an operating margin that may be different from the operating margin originally calculated by the Commission Staff in its exhibits. In our judgment, we may hold that, upon balancing the various Bluefield and Seabrook Island factors, we may arrive at a number not specifically found in the record. This Commission has been held to be “akin to a jury of experts.” Although an empanelled jury in a Court in a civil case must arrive at a damages verdict based on the evidence, it is not required to make a finding of exactly the amount of money damages argued by either the plaintiff or defendant. We believe that this situation is analogous to the present one, even though the Commission does not grant damages. Although one number in this case, 10.88%, may have been proffered as an appropriate operating margin, we do not believe that we are bound by this number because it is the only operating margin mentioned specifically in the evidence. We believe that we, as a jury of experts, have the right to arrive at an appropriate operating margin, as long as it is based on an appropriate level of revenues and income. We believe that we did that in the present case. Thus, Palmetto’s last ground is without merit, and Palmetto’s Petition is denied and dismissed.

Palmetto had also requested that, should its Petition be denied, that this Commission approve a bond pursuant to S.C. Code Ann. Section 58-5-240 (D)(Supp. 1999), so that Palmetto may place the requested rate schedule under bond during appeal. The Company has submitted a proposed bond form to be executed by a surety company authorized to do business in South Carolina, and suggests that the figure of \$125,000 is an adequate bond to be posted. Palmetto

also requests that this Commission allow Palmetto to make any refunds required if the rates put into effect are finally determined to be excessive by crediting existing customers' bills.

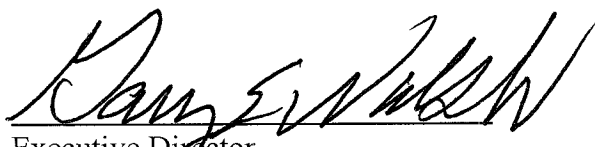
We have examined the bond form and the proposed amount, and approve both, solely for the purpose of allowing Palmetto to place the requested rate schedule into effect during the appeal of this case, as required by the aforementioned statute. We make no ruling at this time on the form of refunds, if any, to be provided to customers, should our positions be upheld by the Courts, but will rule on this issue, if need be, at a later time.

This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:


Chairman

ATTEST:


Executive Director

(SEAL)